Internal Revenue Service

memorandum

CC:TL-N-10489-90
Br4:RJBasso

date: DEC 6 1990

to: District Counsel, Boston NA:BOS
Attn: Madlyn B. Coyne

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted]

This memorandum is in response to your request for tax litigation advice dated September 12, 1990, concerning the proper method of valuing the charitable contributions made by the above-named petitioners.

ISSUE

Whether the gift of a fee simple interest in land by a deed, which contains a covenant requiring the property to be kept as open land, should be valued as a restrictive gift even though the donee is a qualified conservation organization.

CONCLUSION

The gift of a fee simple interest in land to a qualified conservation organization should be valued as a restrictive gift if it is subject to a restrictive covenant.

FACTS

The above-named petitioners owned, as tenants in common, two parcels of vacant land on [redacted]. One parcel was designated as lot number [redacted] and the other parcel was designated as lot number [redacted]. On [redacted], petitioners secured an appraisal of lot number 1. On this date, the land was valued at $[redacted]. Although not specifically set forth in the report, it is presumed that the property's value was based on its highest and best use. On [redacted], the petitioners conveyed lot [redacted] to the trustees of the [redacted] ([redacted]) for nominal consideration. The deed contained a covenant which read as follows:

> The Grantees by acceptance of this deed covenant for themselves and their successors and assigns to hold the above described premises for the

conservation purposes set forth in the [redacted] and on the further condition, to be enforceable in equity by the Grantors and their successors in title to their remaining land shown on the Plan, being lots [redacted], that the premises shall be kept as open land in its natural state and no use inconsistent with the above shall be permitted on the premises, such as, by way of example but not of limitation, the erection of buildings and other structures, the dumping of trash or junk, or the removal of soil or loam.

On [redacted], the petitioners conveyed lot [redacted], the other parcel of vacant land, to the trustees of the [redacted] for nominal consideration. Again, the deed contained a restrictive covenant virtually identical to the one above.[1] On the same date as the conveyance, the land was appraised by the same individual who had appraised lot [redacted]. He valued lot [redacted] at $[redacted]. It is presumed that the estimate of the fair market value of this land was based on the highest and best use of the property prior to the conveyance to the [redacted].

On [redacted], petitioner [redacted] conveyed lot [redacted], a third parcel of vacant land owned solely by him, to the trustees of the [redacted] for nominal consideration. Once again, the deed contained a restrictive covenant virtually identical to the one above.[2] Also, the value of this lot was appraised at $[redacted] as of [redacted]. It is presumed that the estimate of the fair market value of this land was based on the highest and best use of the property prior to the conveyance to the [redacted].

The petitioners claimed charitable contribution deductions based on the estimated fair market value of each parcel of land as determined by the appraiser. The Service's engineer determined that the gifts should be appraised under the "conditional or restrictive gift principles." Consequently, he estimated the value of each lot to be $[redacted]. The petitioners argue that the engineer's theory of valuation is inappropriate because these gifts are qualified conservation contributions within the meaning of I.R.C. § 170(h). Although petitioners acknowledge that qualified conservation contributions are gifts of partial interests in property, they contend that a gift of a fee simple interest to a qualified donee for conservation purposes is tantamount to two simultaneous gifts of real property interests: a restriction (granted in perpetuity) on the use which may be made of the real property, I.R.C. § 170(h)(2)(C), and a gift of a remainder interest, I.R.C. § 170(h)(2)(B).

DISCUSSION

Due to the nature of the issue involved in this case, we requested technical assistance from IT&A. Enclosed please find a copy of the memorandum that IT&A sent to this office. IT&A has concluded that petitioners' contributions are properly

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[1] The only difference was that this covenant could be enforced by the owners of lots [redacted] and [redacted].

[2] The only difference was that this covenant could be enforced by the owners of lots [redacted] and [redacted]

valued as restrictive gifts in accordance with Treas. Reg. § 1.170A-1(c). The discussion that follows is intended to supplement the analysis contained within the memorandum from IT&A.

Petitioners contend that the substance of each of their gifts is the same as a gift of two separate qualified real property interests. Petitioners assert that inasmuch as each of their gifts created a restriction on the use which may be made of the land, that part of the gift is equivalent to a qualified conservation restriction and, therefore, should be valued in the same manner as a qualified conservation restriction. Additionally, petitioners assert that because they conveyed the remainder of their property at the same time, they should be allowed a deduction for the gift of a remainder interest too. Finally, petitioners contend that the value of the sum of these partial interests is equal to the fair market value of the land before any restrictions.[3]

Although petitioners "conveyed the remainder of their property" at the same time they created a restriction on the use of the land, they did not convey a "remainder" as that term is used in property law. A remainder interest is a future interest. See Restatement of Property § 156 (1936). A future interest is characterized by the right to possession at some time in the future. Id. at § 153. In the instant case, the [redacted] obtained the right to possession at the time of the conveyance. Consequently, the [redacted] obtained a fee simple interest in the land as opposed to a remainder interest. The characteristics of each of these property interests are quite different. Compare id. at § 153 (future interests) with id. at § 14 (fee simple interests). In the instant case, petitioners have made a gift of a fee simple interest that was subject to a restriction.

The restriction that petitioners created is much different than a qualified conservation restriction. Qualified conservation restrictions may be in the form of "easements and other interests in real property that under State property laws have similar attributes (e.g., a restrictive covenant)." S. Rep. No. 1007, 96th Cong., 2d Sess. 10 (1980), reprinted in 1980-2 C.B. 599, 603. However, these contributions must be made "exclusively for conservation purposes." I.R.C. § 170(h)(1)(C). These contributions shall not be treated as made exclusively for conservation purposes unless the conservation purpose is protected in perpetuity. I.R.C. § 170(h)(5)(A). "By requiring that the conservation purpose be protected in perpetuity, the committee intends that the perpetual restrictions must be enforceable by the donee organization

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[3] We would note that the combined value of a qualified conservation restriction and a remainder interest does not equal the fair market value of the land without any restrictions. Under the regulations, the gift of a remainder interest is valued in light of any restrictions placed on the use of the land.

> In the case of a contribution of a remainder interest for conservation purposes, the current fair market value of the property (against which the limitations of § 1.170A-12 are applied) must take into account any pre-existing or contemporaneously recorded rights limiting, for conservation purposes, the uses to which the subject property may be put.

Treas. Reg. § 1.170A-14(h)(2).

(and successors in interest) against all other parties in interest (including successors in interest)." S. Rep. No. 1007, 96th Cong., 2d Sess. 14 (1980), reprinted in 1980-2 C.B. 599, 605. Furthermore, the legislative history of I.R.C. § 170(h) emphasizes the importance of having a qualified organization hold the restriction for conservation purposes.

> [I]t is intended that a contribution of a conservation easement or remainder interest qualify for a deduction only if the holding of the easement (or, in the case of a remainder interest, the property) is related to the purpose or function constituting the donee's purpose for exemption (organizations such as nature conservancies, environmental, and historic trusts, State and local governments, etc.) and the donee is able to enforce its rights as holder of the easement or remainder interest and protect the conservation purposes which the contribution is intended to advance.

H.R. Conf. Rep. No. 263, 95th Cong., 1st Sess. 30-31 (1977), reprinted in 1977-1 C.B. 519, 523. Later, it was stated "[t]he committee contemplates that the contributions will be made to organizations which have the commitment and the resources to enforce the perpetual restrictions and to protect the conservation purposes." S. Rep. No. 1007, 96th Cong., 2d Sess. 14 (1980), reprinted in 1980-2 C.B. 599, 606; see also Treas. Reg. § 1.170A-14(c)(1).

The gift of a qualified conservation restriction results in the creation of a permanent burden and a permanent benefit. The burden runs with the land retained by the donor, and the benefit is in gross and must be held by an organization committed to conservation purposes. Treas. Reg. § 1.170A-14(c)(2).

Although petitioners placed a restriction in each of the deeds, that restriction created a burden and a benefit that differs from the burden and benefit created by a qualified conservation restriction. Instead of retaining the land burdened by the restriction, petitioners have transferred this land to the [redacted]. Instead of transferring a benefit in gross to a qualified organization, petitioners have retained this benefit and made it appurtenant to their nearby lots.[4] Accordingly, petitioners have retained the right to enforce the restriction against the [redacted] and its successors in title. In contrast, after a gift of a qualified conservation restriction is made, the qualified conservation organization has the right to enforce the restriction against the donor and his successors in title. The restrictive covenants placed in the deeds by petitioners are not similar to qualified conservation restrictions. Petitioners have kept something of value that they would not otherwise have retained if they had made their gifts through a transfer of a fee simple absolute without a restrictive covenant. Therefore, petitioners' contributions are properly valued as restrictive gifts in accordance with Treas. Reg. § 1.170A-1(c), Deukmejian v. Commissioner, T.C. Memo. 1981-24, and Rev. Rul. 85-99, 1985-2 C.B. 83.

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[4] Each of the covenants contain the phrase "to be enforceable in equity by the Grantors and their successors in title to their remaining land shown on the Plans ... ."

We are returning the file containing the various documents that we received in connection with your request for tax litigation advice. If you have any questions or need further assistance in this matter, please contact Robert J. Basso at FTS 566-3308.

MARLENE GROSS
Assistant Chief Counsel
(Tax Litigation)

By: Robert B. Miscavich
ROBERT B. MISCAVICH
Senior Technician Reviewer
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Enclosures:
Memorandum to IT&A
Memorandum from IT&A
File containing various documents